No. 644

In the Supreme Court of the United States

October Term, 1941

Guy T. Helvering, Commissioner of Internal Revenue, petitioner,

v.

Cement Investors, Inc., respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF FOR THE RESPONDENT

THE W. H. KISTLER STAT'Y CO., DENVER

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OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 13-22) is unpublished. The opinion of the Circuit Court of Appeals (R. 194-200) is reported in 122 F. (2d) 380.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered July 24, 1941 (R. 200-201). Petitioner filed Petition for Writ of Certiorari on September 23, 1941. The Supreme Court denied certiorari on February 9, 1942. The Commissioner then filed petition for rehearing on February 28,

1942. This petition was granted on March 9, 1942. The Commissioner has invoked the jurisdiction of this court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Where a taxpayer exchanged defaulted bonds and the equities represented thereby for bonds and stock of a new company, which acquired all the assets of the insolvent predecessor, and immediately after such exchange the taxpayer and the other former bondholders owned all the outstanding stock of the new company, was taxable gain realized?

Sections 112 (b) (5), 112 (b) ~~(3)~~ and 112 (g) of the Revenue Act of 1936 are determinative of this question.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are set forth in the Appendix, infra, pages 23-26.

STATEMENT.

Respondent has nothing to add to Petitioner's Statement of Facts.

SUMMARY OF ARGUMENT.

This case falls squarely within the terms of Section 112 (b) (5), for property was transferred to a new corporation in exchange for stock control. It was so held by the Court below in accordance with the unanimous authority of the only cases in point which have been cited. The bonds and the claims and equities represented thereby were property within the meaning of the statute. They were transferred to the new corporation and for its benefit. The bondholders received in exchange stock control.

The Circuit Court of Appeals for the Tenth Circuit unanimously held that no gain was realized in this case

because the exchange came within the provisions of Section 112 (b) (5). Two of the Judges on that Court, moreover, held that the transaction was nontaxable as a reorganization under Sections 112 (b) (3) and 112 (g) (1) (C).

The conclusion that the transaction involved no gain under Section 112 (b) (5) was completely in harmony with the case of *Helvering v. Southwest Consolidated Corporation*, No. 286, and the other three reorganization cases decided February 2, 1942. Section 112 (b) (5) was not involved in any of those cases, but they did establish the principle that in this type of transaction the bondholders are the real parties in interest and that the mechanics of consummation are not material.

It is admitted, however, that under the decision in the *Southwest Consolidated Corporation case*, supra, the secondary holding of the court below that the bondholders had become stockholders, thus creating a nontaxable reorganization under Section 112 (b) (3), is no longer tenable.

ARGUMENT.

I.

THE PROVISIONS OF SECTION 112 (b) (5) OF THE REVENUE ACT OF 1936 PRECLUDE THE RECOGNITION OF GAIN OR LOSS IN THIS TRANSACTION.

1. Section 112 (b) (5) of the Revenue Act of 1936 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; and further that in the case of an exchange by two or more persons, the amount of stock or securities received by each must be substantially in proportion to his interest in the property prior to the exchange. As was stated in the opinion of the Circuit Court of Appeals below (R. 197-199):

"The elements which constitute a nontaxable exchange under § 112 (b) (5) are that

(a) Property
(b) Be transferred to a corporation
(c) Solely in exchange for stock or securities in such corporation, and that
(d) The transferors immediately after the exchange be in control of the corporation, through ownership of 80 percent of all voting stock and at least 80 percent of all other classes of stock of the corporation.

Under § 112 (b) (5), a reorganization is not an essential element.

Both Industrial and the Colorado Company, as guarantor, had defaulted in the payment of the interest and principal of Industrial's bonds. The defaults had not been cured, and neither Industrial nor the Colorado Company was able to cure them. *There was no equity in the properties over and above the bonded debts secured by Industrial's mortgage and the Colorado Company's mortgage.* The holders of Industrial's bonds were entitled to a satisfaction of their indebtedness from the mortgaged property, or a statutory substitute therefor under § 77B. *They had acquired equitable rights in the property* and were entitled to have it disposed of under a plan, fair and equitable to them. On the approval of the petitions under § 77B, the property of Industrial and the Colorado Company came under the jurisdiction of the bankruptcy court and private rights in respect to the res became subject to the superior dominion of the court and were to be adjudicated pursuant to the standards prescribed in § 77B. Since no equity remained in the properties for the preferred and common stockholders, the properties passed under the jurisdiction of the court empowered to make fair and equitable disposition thereof for the benefit of the bondholders. *In the exercise of that jurisdiction the bankruptcy court ordered the equitable rights and interests of the bondholders in the properties to be transferred to the Colorado Corporation in exchange for stock and bonds of that corporation.* Pursuant to the order, all of the assets of Industrial and the

Colorado Company were transferred to the Colorado Corporation. *In substance, Industrial's bondholders were the transferors.*

Furthermore, the bonds of Industrial were property in the hands of the holders thereof and they were transferred to the Colorado Corporation in exchange for all of the voting stock thereof, and under the plan no additional stock was to be presently issued. The warrants gave no rights to the holders thereof to vote or otherwise exercise the rights of stockholders.

Hence, property was transferred to the Colorado Corporation solely in exchange for stock and securities of such corporation and immediately after the transfer the bondholders, the transferors, were in control of the Colorado Corporation, owning all of its stock, and no gain or loss should be recognized by reason of the provisions of Sec. 112 (b) (5)." (Italics ours.)

The Petitioner cites no authority to overcome the logic and common sense of this opinion—in fact before the Board and the Court below, he dismissed the whole issue of Section 112 (b) (5) without so much as an argument. Now, finally forced to the wall, he counters with inapplicable analogies, weak weapons to face the plain meaning of the statute and a sound, unanimous decision of the Circuit Court of Appeals. That opinion, in turn, was not unique. The following decisions are all directly in point. They constitute not the weight of authority, but unanimous authority:

In *Leckie v. Commissioner*, 37 B. T. A. 252, petitioner owned bonds of the Morgan Properties Company, whose assets were foreclosed and transferred to a new company, Industrial Properties, Inc. Through a protective committee the bondholders received stock in the new company in exchange for the bonds. In holding this a nontaxable exchange, the Board said (page 257):

"* * * Section 112 (b) (5) is clearly applicable and under it no finding need be made that there was a reorganization. * * * Petitioner and a majority

of the bondholders, in 1933, transferred their bonds to the committee; but they remained the equitable owners of them. When, in 1934, the committee transferred the property and bonds held by it in trust for the bondholders, to the new corporation in exchange for all its stock, the committee held such stock as trustees for the bondholders and they, through their trustees, were in control of the new corporation. The plan contemplated that the stock of the new corporation would be 'distributed or exchanged * * * pro rata among the depositing bondholders', and this was subsequently carried out. It seems clear, therefore, that the exchange in 1934 came squarely within section 112 (b) (5) and hence no gain or loss is to be recognized."

Again, in *Rockford Brick & Tile Co. v. Commissioner*, 31 B. T. A. 537, creditors of an insolvent concern assigned their claims to a creditors committee, which organized a new corporation to which the insolvent corporation transferred certain assets in exchange for the stock of the new corporation, which was distributed to the assigning creditors. The Board held that no gain or loss should be recognized, in view of the provisions of Section 112 (b) (5) (page 540):

> "In the instant case, the creditors of the Albert Lea Farms Co. turned over their claims to the creditors' committee. The creditors' committee organized the new corporation, the Hollandale Farms, Inc., and distributed stock in that company to the creditors in proportion to their claims. This brought the transaction clearly within the provisions of section 112 (b) (5) and the creditors, through the committee, were immediately in control of the corporation on account of their ownership of all its capital stock. This constituted an exchange of the creditors' claims (petitioner being one of them), against the Albert Lea Farms Co. for stock in the Hollandale Farms, Inc., and no gain or loss resulted by reason of this transaction."

In *Miller & Paine v. Commissioner*, 42 B. T. A. 586, creditors of a New Jersey corporation which had conveyed all of its assets to a New York corporation, received shares

of stock in the New York corporation in exchange for their indebtedness. The Board again held that no gain or loss was realized, by reason of the provisions of Section 112 (b) (5).

In the recent case of *Reed v. Commissioner*, 45 B. T. A. No. 173, the same conclusion was reached where creditors released their claims against an insolvent corporation and, through a complicated series of exchanges, came out with the controlling stock interest in a new corporation. Speaking of the complicity of the maneuvers, and the fact that the exchange was not directly one of notes in the old corporation for stock in the new corporation, the Board stated (p. 7):

> " * * * However, the petitioners insist that no such exchange was accomplished because the notes were not transferred to Sutherland. The facts show that the Investment notes were exchanged for the Miller notes, which in turn were delivered to the depositary for the noteholders' committee. The depositary was instructed to deliver the Miller notes as Sutherland might direct. Sutherland directed the delivery to the trustee of the Miller mortgage. From the trustee, Sutherland received a release of that mortgage, thereby becoming the owner of the property free from any lien. The result was exactly the same as if the Investment notes had been transferred to Sutherland. *We fail to perceive any reason why the transaction should not be viewed as a whole and held to be an exchange, even though neither the Investment notes nor the Miller notes were directly exchanged for the stock of Sutherland.* Cf. *Rockford Brick & Tile Co.*, 31 B. T. A. 537. * * * We hold that it was an exchange within the meaning of section 112 (b) (5), Revenue Act of 1936, and that no loss can be recognized." (Italics ours.)

A similar holding is necessarily implied in an analogous line of cases, where the transferee corporation endeavored to step up the value of intangible assets acquired to the market value at the time of acquisition. Such step-up of the

intangibles themselves is not permissible if the transaction falls within the provisions of Section 112 (b) (5). Section 113 (a) (8).

Thus, in *Portland Oil Co. v. Commissioner*, (C. C. A. 1) 109 F. (2d) 479, an installment contract was transferred to a corporation in exchange for its stock by one party and cash was delivered for the balance of the stock by other parties. The corporation contended that it was entitled to a cost basis on the installment contract represented by its fair market value at the date of the transfer, but the Court held otherwise; applying Section 112 (b) (5) to the transaction. The court discusses this section at some length, pointing out that it is applicable "in the absence of a corporate reorganization" (page 489) and stating the purpose of this section in the following language (page 488):

> "It is the purpose of Section 112 (b) (5) to save the taxpayer from an immediate recognition of a gain, or to intermit the claim of a loss, in certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture."

Again, in *Birren & Son v. Commissioner*, (C. C. A. 7) 116 F. (2d) 718, the transferee corporation acquired an undertaking business, including accounts receivable, in exchange for 98% of its stock. The Court held that so far as the tax basis of the accounts receivable was concerned, the transferee stepped into the shoes of the transferor, since no gain was recognized to the transferor under the provisions of Section 112 (b) (5).

To the same effect is *Meagher v. Commissioner*, 20 B. T. A. 68, where installment obligations were conveyed to a corporation in exchange for its capital stock.

Thus, there are cases in which bonds, unsecured claims, installment contracts and accounts receivable were trans-

ferred to corporations in exchange for stock and no gain or loss was recognized under Section 112 (b) (5) or the corresponding section of previous laws. It is significant that counsel for the Petitioner cites not one single case in direct support of the contention that Section 112 (b) (5) does not apply. Nor have counsel for the Respondent been able to find any case supporting Petitioner's contention.

It is submitted, therefore, that under all of the authorities the elements which constitute a nontaxable transfer under Section 112 (b) (5) are present in this case.

2. Counsel for Petitioner contend that *Helvering v. Southwest Consolidated Corporation*, No. 286, decided February 2, 1942, governs the decision in this case. That case, however, involved the basis of the corporate assets in the hands of the transferee and not, as here, the taxability of the exchange to the transferor. There "reorganization" was the primary issue involved. Here the primary issue is the applicability of Section 112 (b) (5), which is entirely independent of, and does not require, "reorganization". Section 112 (b) (5) was not involved in the *Southwest Consolidated* case, and could not be applied, since nonparticipating bondholders were paid off in cash.

It may be noted that counsel for Petitioner conclude this argument on the applicability of the *Southwest Consolidated* case with the statement that "the real issue before the Court is whether recognition of gain or loss upon the exchange may nevertheless be avoided under Section 112 (b) (5)". (B. 14).

3. The Petitioner then asserts that under Section 112 (b) (5) the Industrial bondholders did not transfer any property to the new corporation.

The bonds of the Industrial Company were property within the meaning of this section; so were the claims represented by those bonds; so were the equities represented thereby in the assets of the old corporation. In fact, the

bonds represented the only value in those assets, since the equity of the stockholders in the old company had disappeared. Disregarding the technicalities and the shell of legal title, the bondholders were the equitable owners of the properties of the old corporation. As stated by the Circuit Court of Appeals "In substance, Industrial's bondholders were the transferors". (R. 198).

If the Industrial bondholders transferred nothing to the new corporation, then there was no consideration for the issuance of the new securities to them. These bondholders received all of the stock and bonds issued by the new corporation, so that in substance they must have transferred property to the new corporation, or they would not be entitled to the securities which they received in exchange.

As stated in the Plan of Reorganization, approved by the District Court:

> "The Plan gives to the holders of the Industrial Bonds the entire ownership and control of the new company." (R. 70).

Suppose, for instance, A owns real estate worth $20,000.00, subject to a mortgage of $10,000.00 owned by B. They both transfer their rights to a corporation, taking its stock in exchange equally. The transaction would be non-taxable under Section 112 (b) (5); yet the property transferred by B remains an asset in the hands of the corporation only in the sense that it does in the case at bar. B's contribution represents a half interest in the property transferred; it relieves the corporation of a lien against the property transferred by A. B's contribution inures to the corporation's benefit, just as clearly as A's. If, in the foregoing illustration, it should be assumed that B's mortgage amounted to $20,000.00, and that he received all the stock, the situation would be identical with the case at bar.

The opinion of Mr. Justice Douglas in the case of *Alabama Asphaltic Limestone Company v. Commissioner*, No. 328, decided February 2, 1942, stated in part as follows:

"* * * When the equity owners are excluded and the old creditors become the stockholders of the new corporation, it conforms to realities to date their equity ownership from the time when they invoked the processes of the law to enforce their rights of full priority. At that time they stepped into the shoes of the old stockholders. The sale 'did nothing but recognize officially what had before been true in fact.' *Helvering v. New Haven & S. L. R. Co.*, (C. C. A. 2d) 121 F. (2) 985, 987."

To the same effect are: *Mascot Stove Co. v. Commissioner*, (C. C. A. 6) 120 F. (2d) 153, certiorari denied February 2, 1942; *D. W. Klein Co. v. Commissioner*, (C. C. A. 7) 123 F. (2d) 871; *Templeton's, Jewelers, Inc. v. U. S.*, (C. C. A. 6) decided March 4, 1942, not officially reported, but reported in Prentice-Hall 1942, Par. 62,527; *Helvering v. New Haven & S. L. R. Co., Inc.*, (C. C. A. 2) 121 F. (2d) 985. In the last case, Mr. Justice L. Hand's opinion describes the essence of the matter as follows (P. 987):

"* * * *as soon as the debtor becomes irrevocably insolvent and the debts are due; the creditors are then entitled to control the property, and thereafter its adventures, are their own. The debtor loses any rightful power to dispose of it except for an adequate price, and courts like to speak of him as a 'trustee';* all that is necessary to make them complete legal owners is that they shall follow the prescribed legal formalities. The purpose of such statutes as Sec. 112 was to make mere formal changes immaterial either for gain or loss; if the taxpayer's succeeding interest was for practical purposes the same, the Act wished to treat any change of value as 'unrealized' in accordance with the underlying presupposition of the income tax throughout, that variations in the value of property are negligible unless they take form in some substantially new interest. The changes in the case at bar were not of that kind; *the bondholders were as much the owners before foreclosure as after;* the decree and the sale did nothing but recognize officially what had before been true in fact." (Italics ours.)

The statute does not limit the broad all-inclusive word "property"—in fact the legislative history of the section indicates that Congress intended it in its broadest meaning. Thus the Acts of 1921 and 1924 alternated the use of the word "property" in this connection with the phrase "property real, personal or mixed", substituting one for the other as merely "clerical" or "minor" changes. Revenue Act of 1921, Section 202 (c) (3); Revenue Act of 1924, Section 203 (b) (4); Report Conference Committee (67th Cong., 1st Sess., H. Rept. 486, p. 18); Report Ways and Means Committee (68th Cong., 1st Sess., H. Rept. 179, p. 13). The phrase "property real, personal or mixed" is, of course, as broad a term as occurs in the ordinary vocabulary.

Similarly, in connection with the Revenue Act of 1928, Congress struck from the basis provision corresponding to Section 113 (a) (8) a parenthetical clause excepting "stock or securities in a corporation a party to a reorganization" from the carry-over basis of property received in a transaction covered by the section corresponding to 112 (b) (5). The report of the Ways and Means Committee (70th Cong. 1st Sess., H. Rept. 2, pp. 18-19) cites the case of the transfer of stock by a taxpayer to a corporation in exchange for its stock as non-taxable under the section corresponding to 112 (b) (5). Since the Act used the term "securities" obviously bonds would fall in the same category.

As Mr. Justice Butler stated in *Fidelity and Deposit Company of Maryland v. Arenz*, 290 U. S. 66, 68:

> " 'Property' is a word of very broad meaning and when used without qualification, expressly made or plainly implied, it reasonably may be construed to include obligations, rights and other intangibles as well as physical things."

Again, in *Helvering v. Gambrill*, 313 U. S. 11, 15, Mr. Justice Douglas said:

"* * * 'property held by the taxpayer' as used in Sec. 101 (c) (8) embraces not only full ownership but also any interest whether vested, contingent, or conditional."

In *De Ganay v. Lederer*, 250 U. S. 376, 381, Mr. Justice Day holding that the physical evidence of intangibles, the bonds, notes and mortgages themselves, constituted property, stated:

"To the general understanding and with the common meaning usually attached to such descriptive terms, bonds, mortgages and certificates of stock are regarded as property. By state and Federal statutes they are often treated as property not as mere evidences of the interest which they represent."

In *Superior Bath House Co. v. McCarroll*, 312 U. S. 176, 179, Mr. Justice Black holding that the term "property" included the income from the use of property, said:

"* * * the word property is by no means limited in all its variations, to actual tangible physical things."

The cases cited under Section 1 of Part I hereof, of course all held that bonds and other intangibles constituted "property" under the very statute in question; and in the cases of *Leckie v. Commissioner*, supra, *Rockford Brick & Tile Co. v. Commissioner*, supra, *Miller & Paine v. Commissioner*, supra, and *Reed v. Commissioner*, supra, claims against the old corporation were extinguished in the exchange and did not survive as assets in the hands of the transferee. It is significant that Petitioner is unable to cite a case in support of his "survival" theory.

4. Petitioner, in Section 2 under Part II of his Brief, is apparently endeavoring to establish the point that the new corporation acquired the physical assets involved as a transaction entirely independent from the exchange of Industrial Bonds for the securities of the new corporation, and that these transactions had no relation to each other.

It is admitted, however, on the authority of *Helvering v. Southwest Consolidated Corporation*, supra, that "the

transaction must be considered as a whole" (B. 21), and the Court Order of June 20, 1936, directing the transfer of the assets and the issuance and distribution of the new securities, stated that the provisions thereof should be a single and entire order and direction:

> "The provisions of this Order directing the transfer and delivery of the properties and assets of the Debtors to the New Company, * * * and the issue by the New Company to or on the order of, and the distribution by, the Reorganization Managers of the New Securities, shall be a single and entire order and direction, notwithstanding the provisions hereof permitting the transfer of said properties and assets forthwith and without awaiting * * * the issue, delivery and distribution of the New Securities." (R. 136.)

Obviously, the claims of the Industrial bondholders could not be disposed of until their bonds were exchanged for the new securities and until this was accomplished, the physical assets were not free and clear in the hands of the new company. The Reorganization Managers were only agents. Logically, from every viewpoint, as the Court ordered, the various transfers involved were but a single transaction, the consummation of which simultaneously was practicably impossible of accomplishment.

Actually the only parties who had anything of value to transfer were the Industrial bondholders. The new corporation was the recipient, the only party on the other side of the transaction that benefited from the transfer. This is the substance of the matter, and this Court is not concerned with the mechanics.

> *Alabama Asphaltic Limestone Co. v. Commissioner*, No. 328; *Palm Springs Holding Co. v. Commissioner*, No. 503; and *Bondholders Committee v. Commissioner*, Nos. 128, 129, decided February 2, 1942; *Labrot v. Burnet*, (C. A. D. C.) 57 F. (2d) 413; *Snowden v. McCabe*, (C. C. A. 6) 111 F. (2d) 743.

The Commissioner's attempt to "atomize the plan" is uncalled for here (*Helvering v. New Haven and S. L. R. Co.*, (C. C. A. 2) 121 F. (2d) 985, 988); and the analysis is contrary to fact.

5. Petitioner, in Section 3 under Part II of his Brief, cites a number of cases involving payment of a debt by the debtor itself, but not involving extinguishment of the debt by the exchange for securities of a third party. Petitioner contends that since these cases hold that no "sale or exchange" is involved where the debt is paid by the debtor, then no "sale or exchange" is involved here, and, consequently, there is no transfer of property.

The cases cited, *Fairbanks v. United States*, 306 U. S. 436, and the line of cases beginning with *Bingham v. Commissioner* (C. C. A. 2), 105 F. (2d) 971, all relate to "sale or exchange" transactions within the capital gain and loss provisions of the applicable Revenue Acts. Such contention is not in point here, because the statutory word under Section 112 (b) (5) is "transfer", not "sale or exchange".

See *Helvering v. Flaccus Leather Co.*, 313 U. S. 247.

Furthermore, *Fairbanks v. United States* arose under the Revenue Acts of 1926 and 1928, before the 1934 amendment making the retirement of bonds equivalent to the exchange of property. This amendment, embodied in Section 117 (f) of the Act of 1936, provides:

> "RETIREMENT OF BONDS, ETC.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness * * * shall be considered as amounts received in exchange therefor."

Thus, even if it is conceded that the transaction here under consideration constituted a surrender for cancellation or a retirement, it is still an exchange by statutory definition.

See *McClain v. Commissioner*, 311 U. S. 527.

Nor are the cases following *Bingham v. Commissioner*, supra, in point. The distinction between the situation there involved and that involved in this case is demonstrated by the following language of the Board of Tax Appeals in the case of *Miller & Paine v. Commissioner*, 42 B. T. A. 586, 593:

> "Among other authorities which petitioner cites in support of its contention are *Hale v. Helvering*, 85 Fed. (2d) 819, affirming 32 B. T. A. 356, and *Bingham v. Commissioner*, 105 Fed. (2d) 971. We think these authorities do not support petitioner's contention. In the *Hale* case there was a compromise by the creditor of his debt for less than face value and the court held that this action of the creditor in accepting in cash a lesser amount than the full face value of his note was not a 'sale or exchange' of his note, so as to bring the loss suffered by the creditor within the capital loss provisions of the statute. To somewhat the same effect is the *Bingham* case above cited.
>
> "If there had been a paying off of petitioner's debt in cash at 10 cents on the dollar, doubtless petitioner would be correct in its contentions under the authorities cited. * * *
>
> "In the instant case there can be no question but that the creditors of the New Jersey corporation, including petitioner, transferred their notes against that corporation to the New York corporation and received in exchange therefor solely stock in the New York corporation. *In other words, they did not receive payment of their debts, but exchanged their debts for a continuing interest in the new corporation.*". (Italics ours).

The distinction is also brought out by the Board of Tax Appeals in *Bowen v. Commissioner*, 37 B. T. A. 412, 417 and *Shuster v. Commissioner*, 42 B. T. A. 255, 259.

Like the term "property", the term "transfer" is all inclusive. As Mr. Justice Stone stated in *Raybestos-Manhattan, Inc. v. United States*, 296 U. S., 60, 62-63:

"While the statute speaks of transfers, it does not require that the transfer shall be directly from the hand of the transferor to that of the transferee. It is enough if the right or interest transferred is, by any form of procedure, relinquished by one and vested in another."

To demonstrate the fallacy of Petitioner's argument on this point, it is only necessary to refer to the Stipulation of Facts, the Plan of Reorganization, the letter of deficiency, the Petitions for Certiorari and Rehearing and his Brief, wherein this transaction is described repeatedly as a "transfer" of property to the corporation or an "exchange" of securities by the bondholders.

In the original determination of deficiency, the Commissioner found that Respondent realized income from an exchange of securities. (R. 8, 9).

The Commissioner's entire case has been based on the assertion that this transaction constituted an exchange of securities giving rise to taxable income under Sections 111, 112 and 117 of the Revenue Act of 1936. If no transfer or exchange of property was involved, no taxable income can result under these sections and the Commissioner is relegated to Section 22 (a) of the Revenue Act, which has never been urged at any stage of this proceeding. He may not now switch to this other section and on a new theory attempt to overthrow the decisions below.

Helvering v. Wood, 309 U. S. 344, 348-9.

Helvering v. Tex-Penn Oil Co., 300 U. S. 481, 498.

6. Counsel for the Petitioner apparently make no argument with regard to the third, fourth and fifth requirements of Section 112 (b) (5) as set forth in the opinion of the Court below, namely: (3) that the exchange was solely for stock or securities in a new corporation; that (4) immediately after the exchange the transferors were in control of at least 80% of the outstanding stock of the new corporation, and that (5) if two or more persons are in-

volved the securities received by each must be substantially in proportion to his interest in the property prior to the exchange.

It is obvious that the first two requirements mentioned above have met with compliance.

On the last requirement the securities received by each Industrial bondholder were not merely "substantially in proportion to his interest in the property prior to the exchange", but the proportion was retained exactly. That was the whole purpose of the reorganization and the statute under which it was concluded. The Federal District Court found specifically in the reorganization proceedings that the Plan was fair and equitable and did not discriminate against any class of creditors or stockholders. (R. 33,126). The conclusion is, therefore, inevitable that the proportionate interest was retained.

7. Under Section 4 of Part II of his Brief counsel contend that in this case Section 112 (b) (5) has no application unless there is a "reorganization" within the definition of Section 112 (g). The only authority cited for this contention is *Helvering v. Southwest Consolidated Corporation*, supra, in which Section 112 (b) (5) was not involved and not even mentioned in the opinion.

Furthermore, an examination of Section 112 of the Act discloses that wherever Congress considered "reorganization" as a necessary element, it was specifically mentioned, and there is no reference whatsoever to "reorganization" in Paragraph 5.

Not only the opinion below but a number of other decisions have definitely held that reorganization is not a prerequisite to the application of Section 112 (b) (5).

Thus, in *Portland Oil Co. v. Commissioner* (C. C. A. 1), 109 F. (2d) 479, 488-9, the Court said:

> " * * * we are satisfied that the facts fall within Section 113 (a) (8), in conjunction with Section 112

(b) (5). *These latter sections, though they overlap somewhat with Section 113 (a) (7), also apply to situations where there may be no technical corporate reorganization.*" * * *

"*But the answer is that we are not now* concerned with the corporate reorganization provisions of the Act, * * *. Section 112 (b) (5) may be applicable in the absence of a corporate reorganization". (Italics ours).

The following cases also have held that a transaction may fall under Section 112 (b) (5) though it fails to qualify under the reorganization provisions: *D. W. Klein Co. v. Commissioner,* (C. C. A. 7) 123 F. (2d) 871; *Skouras v. Commissioner,* 45 B. T. A. No. 159; *Royal Marcher v. Commissioner,* 32 B. T. A. 76; *Handbird Holding Co. v. Commissioner,* 32 B. T. A. 238, *Symington and Sons, Inc. v. Commissioner,* 35 B. T. A. 711, and the cases cited in Section 1 of Part I hereof.

No cases to the contrary are cited by the Petitioner.

8. In the footnote at the bottom of pages 26 and 27 of the Brief, Petitioner infers that it has been necessary for him to take an inconsistent position in other cases in order to protect the revenues, and then states:

"It may be assumed that the reorganization of an insolvent corporation would give rise more frequently to individual losses than gain".

Although not directly within the statutory definition of "reorganization", this case, from a practical standpoint, did involve the reorganization of an insolvent corporation and Respondent concurs in the conclusion stated by the Petitioner. If Section 112 (b) (5) had no application, most of the security holders of corporations reorganized under Section 77-B proceedings would incur taxable losses.

That Congress had just this in mind is shown by the following excerpt from a Committee Report. Act of 1921, Report of House Ways and Means Committee (67 Cong., 1st Sess., H. Rept. 350, p. 10):

"The bill (subdivision (d)[1], p. 6) provides new and explicit rules for determining gain or loss where property is exchanged for other property. * * *

"The preceding amendments, if adopted, will, by removing a source of grave uncertainty, not only permit business to go forward with the readjustments required by existing conditions but will also *considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges.* (Italics ours).

If the Commissioner should prevail in the argument that Section 112 (b) (5) is inapplicable unless there is a technical reorganization, artificial losses would be permitted. If he should prevail on the theory that this transaction was not an exchange, then the losses incurred would be ordinary losses deductible in full and not subject to the limitations placed by recent Revenue Acts on losses from the sale or exchange of capital assets. Internal Revenue Code, Section 117.

II.

IF THE THEORY OF PETITIONER BE SOUND THEN RESPONDENT CONTENDS THAT THE TRANSACTION IN QUESTION CONSTITUTED A REORGANIZATION UNDER SECION 112 (g) OF THE REVENUE ACT OF 1936 AND THAT THE TRANSACTION WAS NOT TAXABLE BY VIRTUE OF THE PROVISIONS OF SECTION 112 (b) (3).

1. Section 112 (g) (1) (C) provides that there is a "reorganization" in the case of "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer *the transferor* or its stockholders or both are in control of the corporation to which the assets are transferred." (Italics ours).

By its decision in the *Southwest Consolidated Corporation* case, supra, this court has found that bondholders cannot become stockholders, but that case did not involve the question of whether the predecessor corporation was in control immediately after the transfer.

If the contention of Petitioner that the Industrial bondholders did not transfer property to the new corporation in this case should be found correct, then such bondholders were not entitled to the securities issued by the new corporation. If, as contended by the Petitioner, the real transferor in this case was the predecessor corporation which conveyed the physical assets to the new corporation, then technically and logically it was entitled to the securities issued by the new corporation and on this theory it would have been in control of the new corporation immediately after the transfer of such assets. Obviously, this is a distortion of the facts as they actually occurred, but the statement demonstrates the fallacy of the Petitioner's position. The only method by which this theory can be reconciled to the fact is to conclude that if the predecessor corporation was actually the transferor then it was in control of the new corporation "immediately after the transfer," and a reorganization within the meaning of the statute resulted.

See *Raybestos-Manhattan, Inc. v. United States*, 296 U. S. 60.

In that case the Court held that the transfer of corporate assets from two old companies to a new company in exchange for securities which were delivered directly to the old stockholders constituted a taxable issue and transfer of the stock in the new company, so that two stamp taxes were assessable —one on the original issue of the stock, theoretically to the old companies, and the other on the theoretical transfer by them to the old stockholders. If the same theory were applied to this case, it could readily be argued that momentarily during the passage of the stock from the new company to the Industrial bondholders the old company was the owner of such stock, and, therefore, "immediately after the transfer" in control of the new company.

2. The door is still open for the contention that the transaction here under consideration constituted a reorganization under the definition contained in Section 112

(g) (1) (A) of the Revenue Act of 1936 in that it was a "statutory merger or consolidation", since the Southwest Consolidated case did not involve Section 77-B of the Bankruptcy Act. That issue is being argued by Respondent in the companion cases *Helvering v. James Q. Newton Trust*, No. 645, and *Helvering v. James Q. Newton*, No. 646. This Respondent has preferred to rely on the applicability of Section 112 (b) (5) and has never felt justified in pressing this argument.

If the Court should find that this exchange was in connection with a "statutory merger or consolidation" or with a "reorganization" under any theory, the judgment of the lower court should be affirmed. As was stated in Footnote 2 in the case of *Bondholders Committee-Marlborough House v. Commissioner*, No. 128, 129, decided February 2, 1942:

> "Though respondent apparently did not urge this point before the Board or the court below, it may of course support the judgment here by any matter appearing in the record. *LeTulle v. Scofield*, 308 U. S. 415, 421, 84 L. Ed. 355, 60 S. Ct. 313, and cases cited."

It is, however, the primary contention of the Respondent that all of the requirements under Section 112 (b) (5) have been met, that "reorganization" has no application to that section, and that thus this transaction constituted a non-taxable exchange.

CONCLUSION.

The judgment of the lower Court should, therefore, be affirmed.

Respectfully submitted,

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*— * * *

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or

more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock; of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 percentum of the total number of shares of all other classes of stock of the corporation.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer * * *

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 112 (b) (5)-1. *Transfer of property to corporation controlled by transferor.*—As used in section 112 (b) (5), the phrase "one or more persons" includes individuals, trusts or estates, partnerships and corporations (see section 1001); and to be in "control" of the transferee corporation such person or persons must own immediately after the transfer at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation. (See section 112 (h).) The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

Example 1: A owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $150,000 in 1936. He transfers this property to the M Corporation, a newly formed company, for all the latter's capital stock. No gain or loss is recognized from the transaction.

Example 2: C owns a patent right worth $25,000 and D owns a manufacturing plant worth

$75,000. C and D organize the R corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example 3: B owns certain real estate which cost him $50,000 in 1920, but which has a fair market value of $200,000 in 1936. He transfers the property to the N Corporation in 1936 for 78 percent of all classes of stock of the corporation, the remaining 22 percent of the stock of the corporation having been issued by the corporation in 1933 to other persons for cash. B realizes a taxable gain of $150,000 on this transaction. (See section 112 (h).)